The Basics of Islamic Banking & Finance

A **Dubai Bank** Publication

INDEX

What is **ISLAMIC BANKING**

The Principles

WHAT IS ISLAMIC BANKING?

- **Islamic banking** refers to a system of banking or banking activity which is consistent with Islamic law (Sharia) principles and guided by Islamic economics.
- In particular, Islamic law prohibits the collection and payment of interest, also commonly called *riba* in Islamic discourse.
- Generally, Islamic law also prohibits trading in financial risk (which is seen as a form of gambling).
- In addition, Islamic law prohibits paticipation in businesses that are considered either detrimental or haram (such as businesses that sell tobacco, ammunition, alcohol or pork, or businesses that produce un islamic media)

The 3 key principles

- Islamic banking is based on the Quranic prohibition of usury (riba)
- Money cannot be used as a commodity or asset
- Transactions must be asset backed

FUNDAMENTALS OF ISLAMIC BANKING

- The fundamentals of Islamic Banking are taken from Shari'a (Islamic Law)
- The five essential principles on which Islamic banking is based consist of :
  - Prohibition on Interest (riba)
  - Prohibition of Uncertainty (gharar)
  - Prohibition on Speculation or gambling (maisir)
  - Restriction on activities/commodities e.g. Alcohol, Arms and Ammunition and Pork
  - Profit and loss sharing mechanism

INTEREST (RIBA)

- Paying or receiving of interest is forbidden as it is considered usury
- Prohibition of a predetermined payment over and above the actual amount received
- Only non-interest loans (Qard-ul-hassan) are permissible by Shari’a

UNCERTAINTY (GHARAR)

- Prohibition of a contract based on the occurrence or the non-occurrence of a future uncertain event
- Counter-parties should have perfect knowledge of the values involved in the transaction hence payment details should be pre-agreed
- Contracts like Istisna'a and Salam which involve delivery of goods at a future date have an element of uncertainty but are permissible by Shari'a

SPECULATION (MAISIR)

- Transactions purely undertaken for speculative purposes are prohibited
- Trading or investment transactions that involve risk are permissible

PROHIBITED ACTIVITIES / COMMODITIES

- Dealing in certain commodities and activities are prohibited by Shari'a
- Islamic banks, therefore, cannot finance enterprises that deal in the following activities/commodities
    - pork
    - tobacco
    - arms and ammunitions
    - cinema
    - interest-based financial services
    - gambling
    - liquor
    - pornography

PROFIT AND LOSS SHARING

- The provider of the capital must share in the profits and losses arising from the underlying activity
- The activity is permissible only if the provider of the capital accepts risks in the activity
- This concept encourages investments as the risk is shared by all parties involved

Conventional vs Islamic

ISLAMIC VS CONVENTIONAL BANKING

- The best-known feature of Islamic banking is the prohibition on interest. Islamic banking aims to encourage risk sharing with higher returns for higher risk taking, with the notion that high-risk investments provide a stimulus to the economy and encourage entrepreneurs to maximize their efforts. The basic principle is to create a system of equitable sharing of risk and rewards.
- Islam encourages investments in order that the community may benefit. The shareholders and depositors should all share the risks and the rewards of financing business ventures.
- This is unlike the interest-based commercial banking system, where all the pressure is on the borrower: to pay back his loan, with the agreed interest, regardless of the success or failure of his venture.
- Islamic banking helps to contribute towards a more equitable distribution of income and wealth and increased equity participation in the economy.

The main product types in Islamic Banks are:

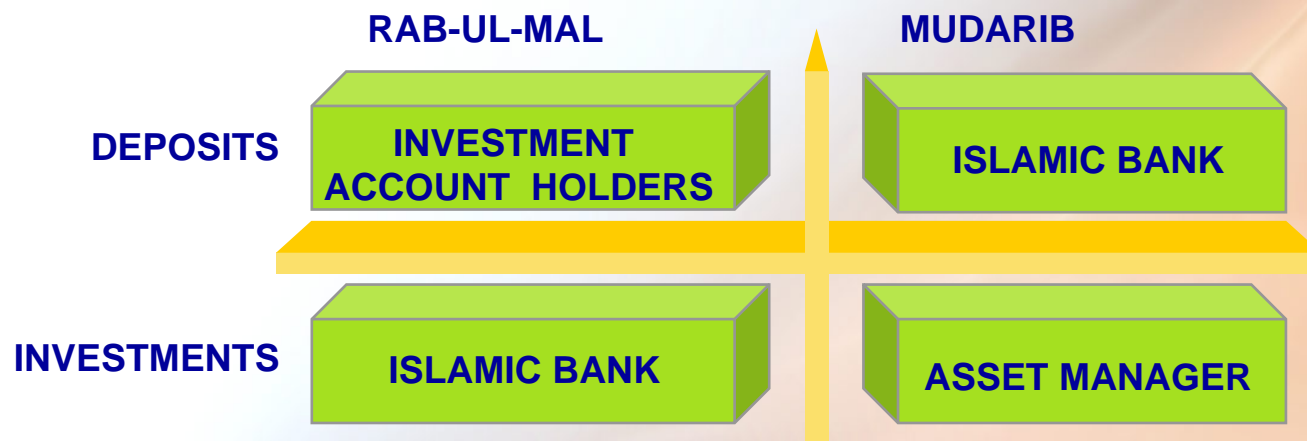
- Mudaraba
- Murabaha
- Musharika
- Istisna'a
- Salam
- Ijara

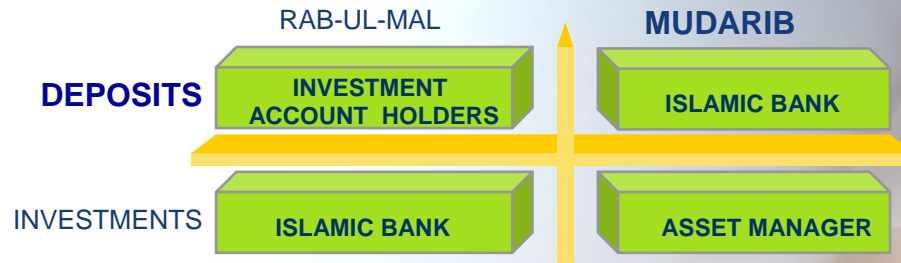
DEFINITION OF MUDARABA

- A Mudaraba is a profit sharing partnership agreement in which the investor (the Rab-ul-mal) provides the necessary finance, while the recipient of the funds (the Mudarib or the manager) provides the professional, managerial and technical know-how towards carrying out the venture, trade or service with an aim of earning profit.

ISSUES

- The Bank may enter into a Mudaraba contract in the following two ways:

1. As Mudarib – Where it manages the deposits of its account holders
2. As Rab ul Mal – Where it provides funds to its customer, an entrepreneur or asset manager

CHARACTERISTICS

The Bank as Mudarib

- Profit from the Mudaraba activity is shared between the Bank (as Mudarib) and the investment account holder (as Rab-ul-mal) in a pre-agreed ratio
- The Bank does not bear any loss but remains responsible for any negligence
- The Bank may receive from its investors compensation (Mudarib fees) in return for management of their funds
- The Bank is bound to return the capital to the investors after deducting any losses or Mudarib fees at the time of winding up of the contract

The Bank as the Rab-ul-mal

- Profit from the Mudaraba activity is shared between the Bank (as Rab-ul-mal) and the Mudarib in a pre-agreed ratio
- The Bank will bear all the loss unless the Mudarib violates the agreement
- The Bank will pay to the Mudarib, compensation (Mudarib fees) in return for management of its funds
- The Mudarib is bound to return the capital to the Bank after deducting any losses or Mudarib fees at the completion of the contract

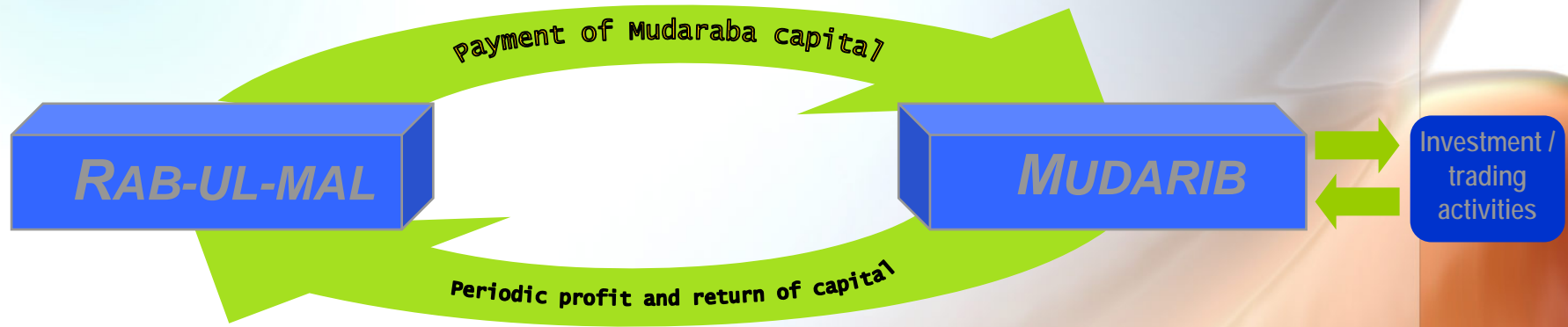
MECHANICS

Payment of Mudaraba capital

RAB-UL-MAL

MUDARIB

Investment / trading activities

Periodic profit and return of capital

- Payment of Mudaraba capital to Mudarib
- Mudarib engages in investment and/or trading activities
- Mudarib pays Rab-ul-mal's share of profit
- Mudarib returns the Mudaraba capital to the Rab-ul-mal on liquidation of the contract

ASSOCIATED RISKS

- **Investment Risks**

  Banks (as Rab-ul-mal) do not hold any “tangible” assets as security, but will not be liable for any losses beyond the capital he has contributed

- **Operational Risks**

  Banks (as Rab-ul-mal) have a lower degree of control over the management of funds

- **Credit Risk**

  Risk of default due to poor credit standings, lack of experience or lack of commitment

- **Market Risk**

  Risk of price fluctuations especially if the Mudarib invests funds in securities. Also includes risk of currency rate fluctuations

MURABAHA MUSHARIKA ISTISNA’A BAI AL SALAM IJARA OTHERS

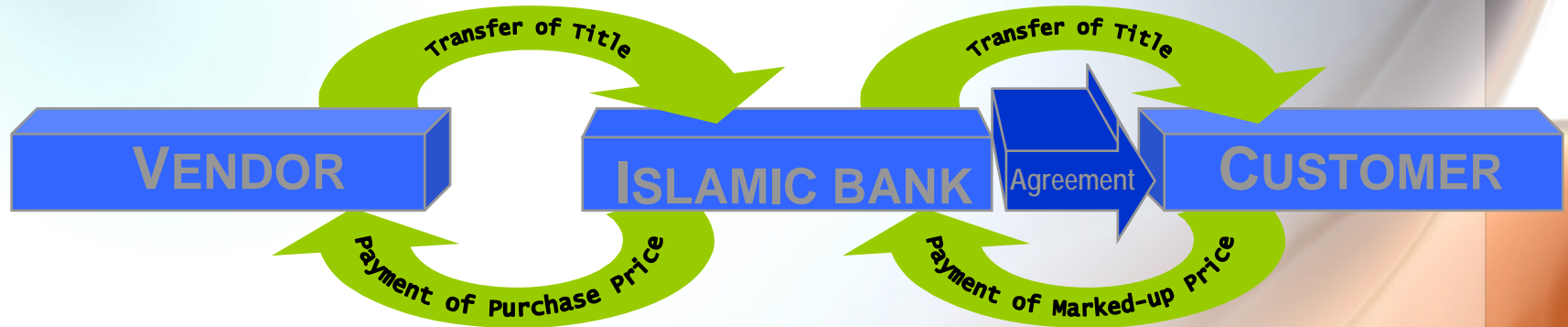
DEFINITION OF MURABAHA

Murabaha is a contract wherein the Islamic bank, upon request by the customer, purchases the asset from a third party supplier/vendor and resells it to the customer either against immediate payment or on a deferred payment basis i.e. Cost plus finance

MUDARABA MURABAHA MUSHARIKA ISTISNA’A BAI AL SALAM IJARA OTHERS

CHARACTERISTICS

- The Bank makes a profit on the difference between the vendor price and the price charged to the customer
- The profit margin is pre-determined by taking into account the period of financing, pattern of disbursement, mode of repayment etc.
- An advance payment (called Hamish Gedyyah) may be received from the customer as a form of security, and will be held in trust on behalf of the customer until the agreement is signed
- The Bank's purchase price for the asset is equivalent to the amount of financing to the customer

MECHANICS

- The customer approaches the Bank with the request for financing
- The Bank purchases and receives title of ownership from the vendor
- The Bank makes payment to the vendor
- The Bank transfers the title over to the customer upon payment to the vendor (back-to-back)
- The customer makes payment up-front or on a deferred basis

ASSOCIATED RISKS

- **Asset Risk**
  The customer may fail to purchase the asset from the Bank, thereby exposing the Bank to Asset Risk
- **Credit Risk**
  Risk of default due to poor credit standings or lack of commitment

DEFINITION OF MUSHARIKA

- **Musharika**
  This is a type of partnership between the Bank and the customer whereby each party contributes to the capital of the partnership in equal or varying proportions either to establish a new venture or share in an existing one

- **Types of Musharika**
  - Permanent Musharika (Equity Participation)
  - Diminishing Musharika (Long-term Musharika)
  - Temporary Musharika (Working Capital Financing)

CHARACTERISTICS

- Musharika agreements can be entered into for a short-term or long-term period
- Profits and losses from the venture are shared by each Musharik in accordance with the Musharika agreement

- The customer approaches the Bank with the request for financing
- The Bank enters into a Musharika agreement with the customer
- Specific role of the two parties in the management of the venture
- Profit from the venture is distributed between the Bank and the customer

ASSOCIATED RISKS

- **Operational Risks**
  - Banks have a lower degree of control over the management
  - Lack of commitment and mismanagement of funds by the Musharika
- **Credit Risk**

  Risk of default due to poor credit standings, lack of experience or lack of commitment

DEFINITION OF ISTISNA'A

Istisna'a is a sale agreement between the Bank as Al-sani (the seller) and the customer as Al-mustasni (the ultimate purchaser) where by the Bank:

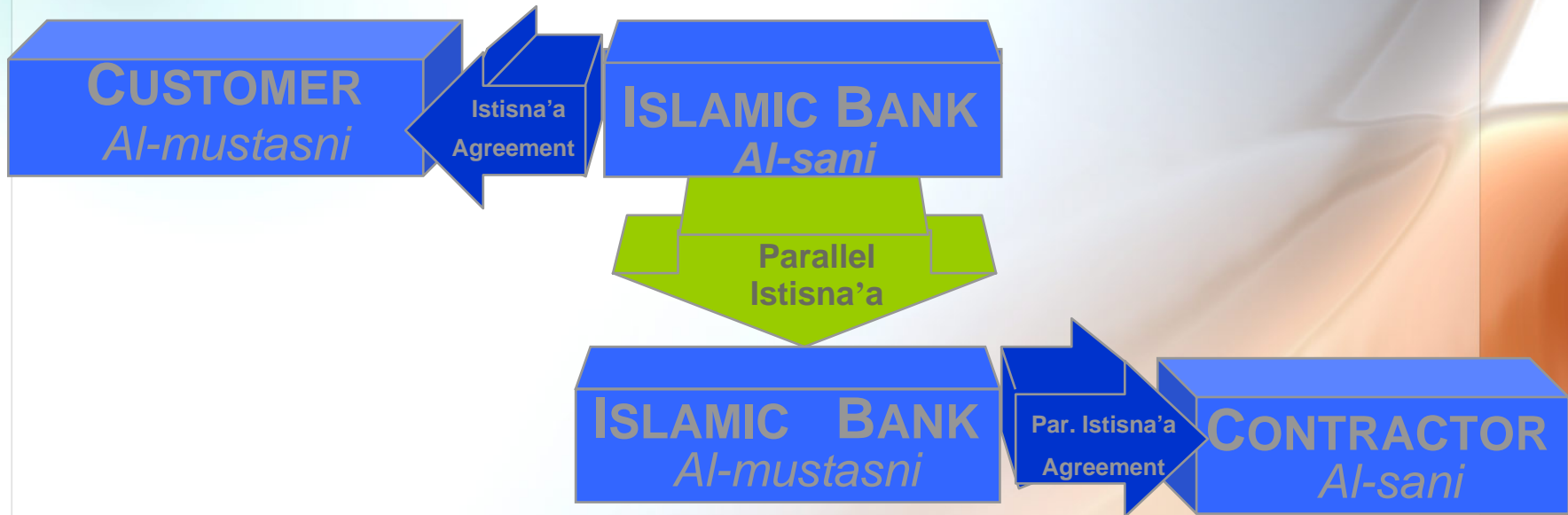
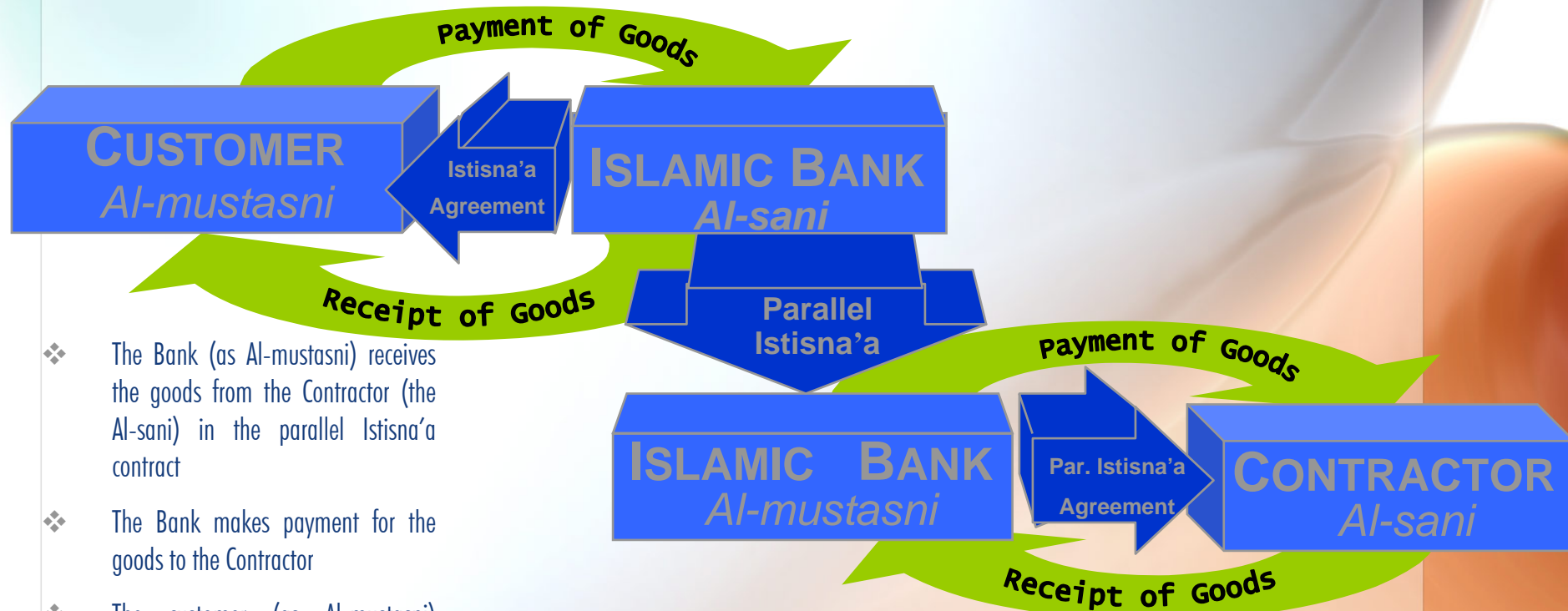
- based on the order from the customer
- undertakes to have manufactured or otherwise acquire the subject matter (Al-masnoo) of the contract
- according to the specifications stipulated by the customer and,
- sells it to the customer for an agreed upon price and method of settlement whether that may be in advance, by instalments or deferred to a specific future date

DEFINITION OF PARALLEL ISTISNA'A

- **Parallel Istisna'a**
  This refers to the second sales contract entered into by the Bank with a subcontractor to fulfil its contractual obligations in the first contract (Istisna'a) to the customer

ISSUES

- The Bank always enters into a parallel Istisna'a contract in order to satisfy its contractual obligations towards the Istisna'a agreement with the customer
- The Bank remains liable for the performance of the Istisna'a contract regardless of whether a parallel Istisna'a exists
- The subcontractor in the parallel contract has no direct relationship with the customer in the first contract

MECHANICS

- The customer approaches the Bank with the request for financing
- The Bank enters into an Istisna'a agreement with the customer
- The Bank enters into a Parallel Istisna'a agreement with the contractor

MECHANICS
Payment of Goods
CUSTOMER
Al-mustasni
Istisna'a
Agreement
ISLAMIC BANK
Al-sani
Receipt of Goods
Parallel
Istisna'a
Payment of Goods
ISLAMIC BANK
Al-mustasni
Par. Istisna'a
Agreement
CONTRACTOR
Al-sani
Receipt of Goods
The Bank (as Al-mustasni) receives the goods from the Contractor (the Al-sani) in the parallel Istisna'a contract
The Bank makes payment for the goods to the Contractor
The customer (as Al-mustasni) receives the goods from the Bank (the Al-sani) in the first Istisna'a contract
The customer makes payment for the goods to the Bank
MUDARABA
MURABAHA
MUSHARIKA
ISTISNA'A
BAI AL SALAM
IJARA
OTHERS

ASSOCIATED RISKS

- **Investment Risks**
  - Customer has no recourse nor any contractual relationship with the actual contractor, hence the Bank is prone to failure
  - Bank has no or little control over the selection process of the contractor
- **Operational Risks**
  Banks have no control over the manufacturing process
- **Credit Risk**
  Risk of default due to poor credit standing or lack of commitment

DEFINITION OF BAI AL SALAM

- **Bai Al Salam**
  Bai Al Salam (also known as Salam) is a contract whereby the Bank (Al-muslam) makes a lump sum payment to a seller (Al-muslam Ileihi) for a specifically defined commodity (Al-muslam Fihi) which will be delivered in the future

- **Parallel Salam**
  This is a second Salam contract entered into by the Bank with the buyer for the sale of the specifically defined commodity which is to be delivered to the buyer on a specified future date for an agreed selling price. The buyer must be a third party and not related to the original seller

ISSUES

- The payment to the seller in the first contract is made at the initiation of the contract, however the delivery of the commodity to the Bank is deferred to a future date as agreed between the Bank and the seller

- On delivery date, the Bank receives the commodity and resells it to the customer in the parallel Salam contract

- The execution of the parallel Salam contract is not contingent upon the receipt of the commodity by the Bank under the first Salam contract

CHARACTERISTICS

- The sale price of the commodity under the parallel Salam contract consists of:
  - cost incurred by the Bank, and
  - the profit margin
- The sale by the Bank under parallel Salam can be either on cash or deferred payment basis

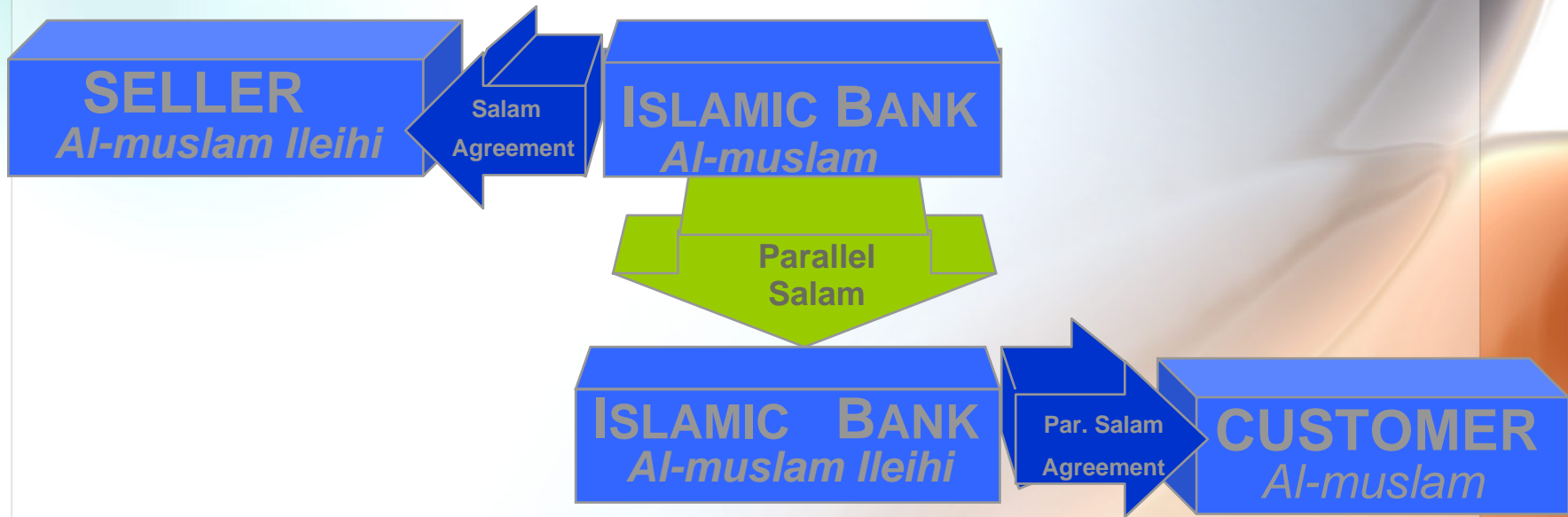
MECHANICS

Salam Agreement

ISLAMIC BANK
Al-muslam

Parallel Salam

ISLAMIC BANK
Al-muslam Ileihi

Par. Salam Agreement

CUSTOMER
Al-muslam

- The seller (Al- muslam Ileihi) approaches the Bank (Al-muslam) with the request for financing
- The Bank enters into a Salam agreement with the seller
- The Bank (Al-muslam Ileihi), then enters into a parallel Salam agreement with the customer (Al-muslam)

MECHANICS

Payment for Commodity (Al-masnoo)

SELLER
Al-muslam Ileihi

Salam Agreement

ISLAMIC BANK
Al-muslam

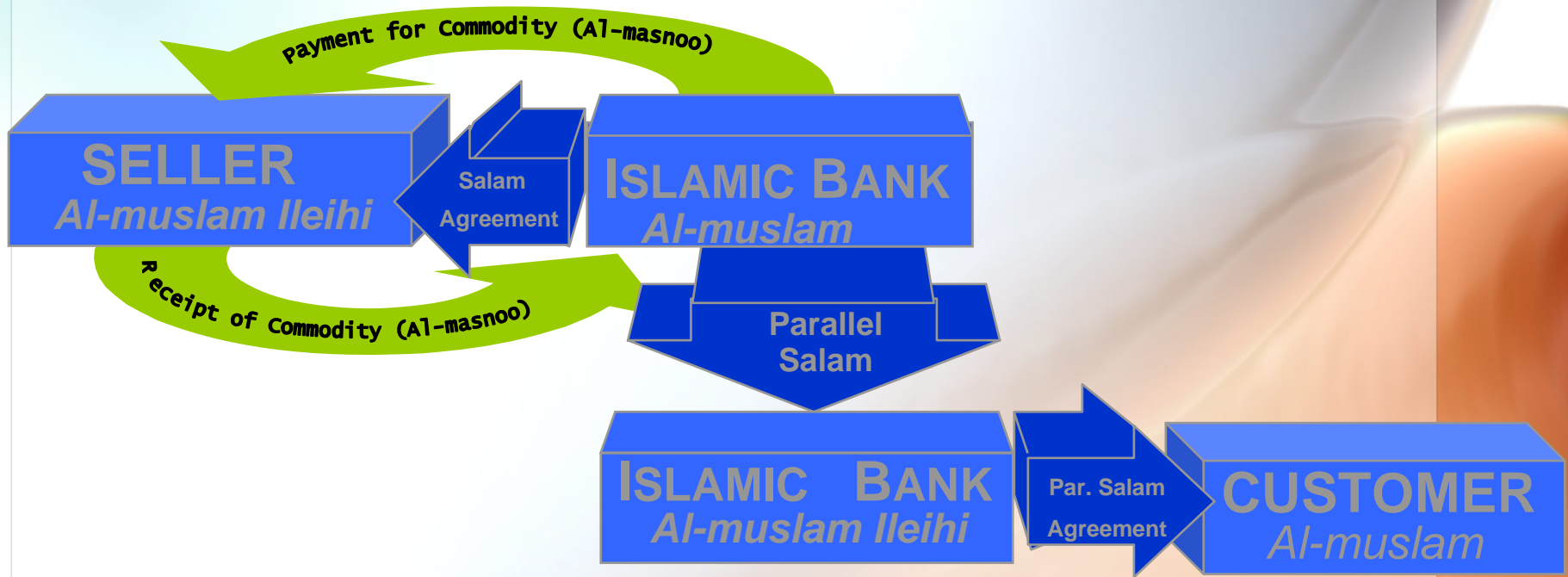
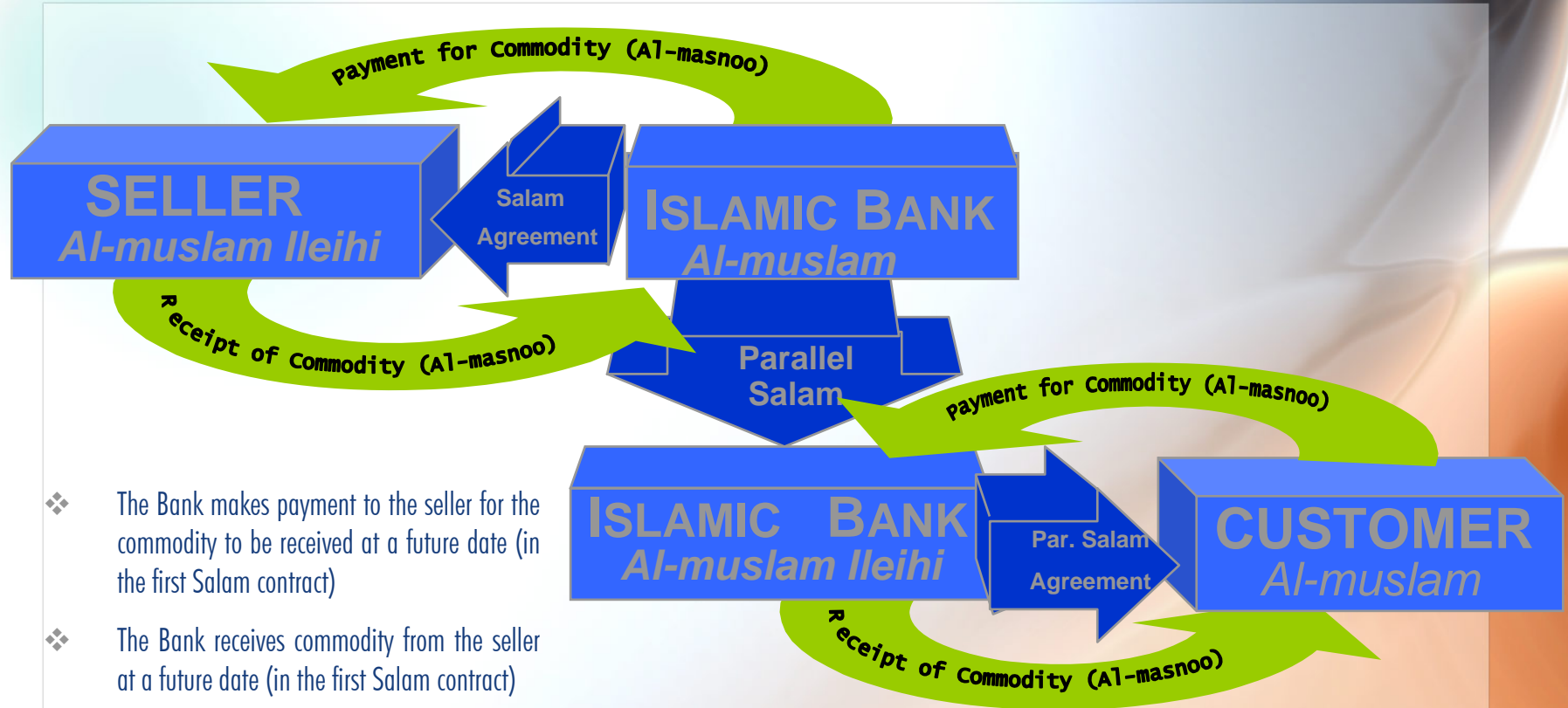
Receipt of Commodity (Al-masnoo)

Parallel Salam

ISLAMIC BANK
Al-muslam Ileihi

Par. Salam Agreement

CUSTOMER
Al-muslam

MECHANICS

Payment for Commodity (Al-masnoo)
SELLER
Al-muslam Ileihi
Salam
Agreement
ISLAMIC BANK
Al-muslam
Receipt of Commodity (Al-masnoo)
Parallel
Salam
Payment for Commodity (Al-masnoo)
ISLAMIC BANK
Al-muslam Ileihi
Par. Salam
Agreement
CUSTOMER
Al-muslam
Receipt of Commodity (Al-masnoo)
The Bank makes payment to the seller for the commodity to be received at a future date (in the first Salam contract)
The Bank receives commodity from the seller at a future date (in the first Salam contract)
The customer (as Al-muslam) receives the commodity from the Bank (the Al-muslam Ileihi) in the parallel Salam contract
The customer makes payment for the commodity to the Bank (in the parallel Salam contract)
MUDARABA
MURABAHA
MUSHARIKA
ISTISNA'A
BAI AL SALAM
IJARA
OTHERS

ASSOCIATED RISKS

- **Investment Risks**
  Customer has no recourse nor any contractual relationship with the seller
- **Operational Risks**
  Banks have no control over the production process
- **Credit Risk**
  Risk of default by the customer due to poor credit standings or lack of commitment

MUDARABA MURABAHA MUSHARIKA ISTISNA'A

IJARA OTHERS

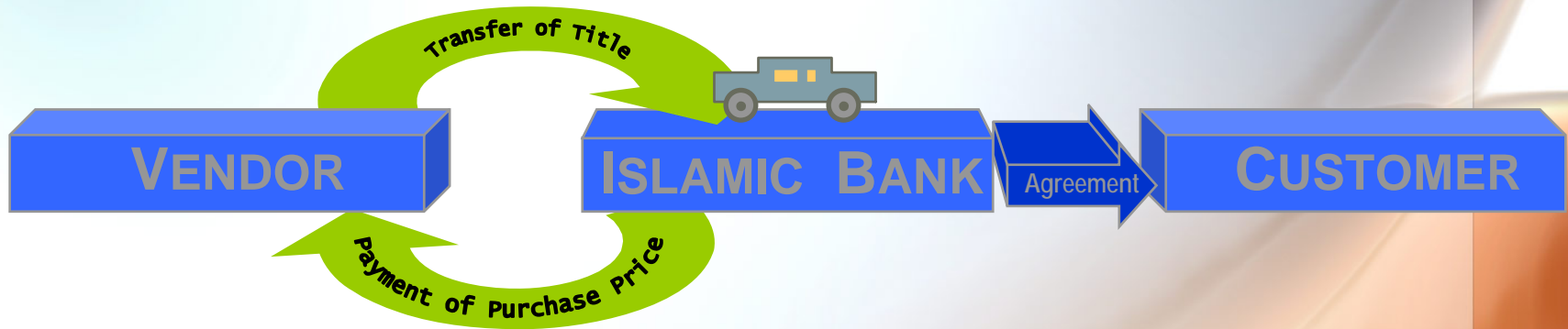
DEFINITION OF IJARA

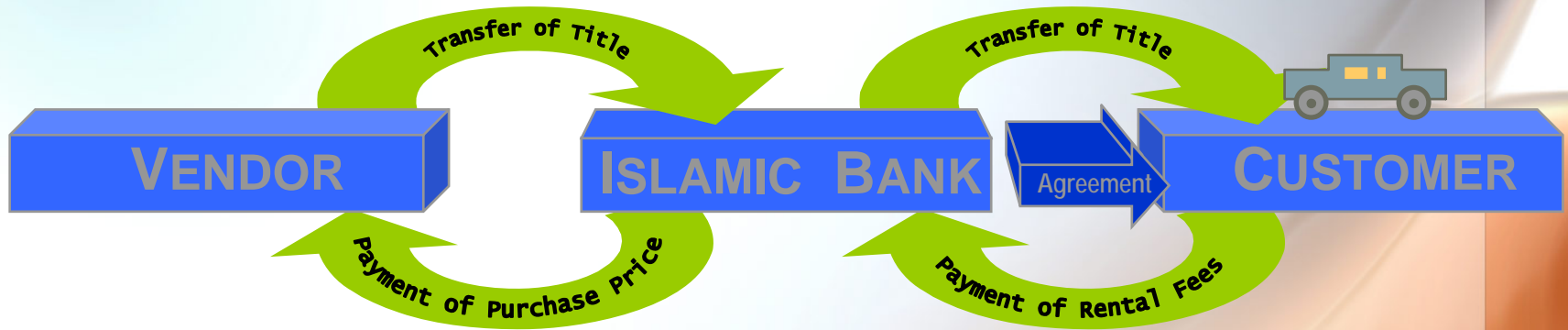
- Ijara
  - Ijara is an operating lease that allows ownership of the right to use an asset in return for consideration
  - The contract does not end with the transfer of the ownership of the asset

DEFINITION OF IJARA MUNTAHIA BITTAMLEEK

- Ijara Muntahia Bittamleek (Hire Purchase)
  - This is a lease that ends with the ownership of the asset
  - There are several types of Ijara Muntahia Bittamleek. These are characterized based on the method by which the ownership transfers to the user:
    - For no consideration (through a gift)
    - For token consideration
    - For price specified in the lease
    - For remaining amount (if lease is terminated before period)
    - Gradual transfer

ISSUES

- Ijara and Ijara Muntahia Bittamleek contracts have three major elements:
  - a form
  - two parties
  - the object of the Ijara contract (usufruct)
- The customer pays to the Bank rental fees in return for the use of the leased asset
- The ownership title of the asset passes on to the customer through one of the methods mentioned under Ijara Muntahia Bittamleek, however the title remains with the Bank at the end of the lease period under Ijara financing

- The customer approaches the Bank with the request for financing
- The Bank purchases the item required for leasing and receives title of ownership from the vendor
- The Bank makes payment to the vendor

MECHANICS

- The Bank leases the asset to the customer
- The customer makes periodic payments as per the contract
- The asset title transfers to the customer based on the method disclosed in the agreement

ASSOCIATED RISKS

- **Investment Risks**
  Banks may not have control over the quality of the asset, hence possibility of rejection by the customer
- **Operational Risk**
  Maintenance and insurance issues
- **Credit Risk**
  Risk of default due to poor credit standings or lack of commitment

DEFINITION OF QARD UL HASAN

- A Benevolent Loan
  - The borrower is only obligated to pay back the principal amount of the loan to the lender
  - Such loans are usually made for special circumstances, such as education loans, social development, etc

DEFINITION OF RESTRICTED INVESTMENT ACCOUNTS

- Restricted Investment Accounts
  - Investment account holder imposes certain restrictions as to where, how and for what purpose these funds are to be invested
  - Funds may be invested on the basis of Mudaraba contract

DEFINITION OF UNRESTRICTED INVESTMENT ACCOUNTS

- **Unrestricted Investment Accounts**
  - Investment account holder imposes no restrictions as to where, how and for what purpose these funds are to be invested
  - The Bank may invest these funds as it deems appropriate
  - The Bank may commingle its own funds with the unrestricted investment account funds for the purpose of investment
  - Funds are invested on the basis of Mudaraba contract

Glossary of TERMS

- Al-Ajr: Refers to commission, fees or wages charged for services.
- Amana/Amanah: Trust.
- Al-wadia: Resale of goods with a discount on the original stated cost.
- Al-wakala: Absolute power of attorney.
- Al-Rahn: An arrangement whereby a valuable asset is placed as collateral for a debt. The collateral may be disposed off in the event of a default.
- Awkaf/Awqaf: A religious foundation set up for the benefit of the poor.

GLOSSARY OF ISLAMIC FINANCIAL TERMS (CONT.)

- Bai'muajjal: Deferred-payment sale.
- Bai al-Dayn: Debt financing: the provision of financial resources required for production, commerce and services by way of sale/purchase of trade documents and papers. Bai al-Dayn is a short-term facility with a maturity of not more than a year.
- Bai al-salam: Pre-paid purchase.
- Bai Bithaman Ajil: This contract refers to the sale of goods on a deferred payment basis (like Murabaha).
- Baitul mal: Treasury.

GLOSSARY OF ISLAMIC FINANCIAL TERMS (CONT.)

- Fatwa: A religious decree.
- Fiqh: Islamic jurisprudence. The science of the sharia. It is an important source of Islamic economies.
- Gharar: Lit: uncertainty, hazard, change or risk. Technically, sale of a thing which is not present at hand, or the sale of a thing whose consequence or outcome is not known, or a sale involving risk or hazard in which one dose not know whether it will come to be or not.
- Hadith: A hadith is a narration about the life of the Prophet (saas) or what he approved - as opposed to his life itself, which is the Sunnah.
- Halal: That which is permissible. The concept of Halal has spiritual overtones, In islam there are activities, professions, contracts and transactions which are explicitly prohibited (haram) by the Qur'an or the Sunnah.

GLOSSARY OF ISLAMIC FINANCIAL TERMS (CONT.)

- Hajj: means pilgrimage to Mecca and other holy places. *Hajj,* the fifth pillar of Islam, is a duty on every Muslim who is financially and physically able to carry it out, at least once in his lifetime.
- Hawala: is an informal value transfer system used primarily in the Middle East, Africa and Asia. Its origins are not entirely clear, but it is believed to have been used first in the financing of long-distance trade in the early medieval period on trading routes such as the Silk Road, the Eastern Mediterranean and the Indian Ocean.
- Hibah (Gift)

GLOSSARY OF ISLAMIC FINANCIAL TERMS (CONT.)

- Ijara: Lit: letting on lease. Technically, sale of a definite usufruct in exchange for a definite reward. Commonly used for rentals, it also refers to a contract of land lease at a fixed (or Variable) rent payable in cash.
  - Leasing is also a lawful method of earning income, according to Islamic law. In this method, a real assets such a machine, a car, a ship, a house, can be leased by one person (lessor) to the other (lessee) for a specific period against a specific price. The benefit and cost of the each party are to be clearly spelled out in the contract so as any ambiguity (Gharar) may be avoided.
  - Ijara Wa-Iqtina (Lease to Purchase): The same as *ijara* except the business owner is committed to buying the equipment at the end of the lease period.

GLOSSARY OF ISLAMIC FINANCIAL TERMS (CONT.)

- Istisna'a (Progressive Financing): A contract of acquisition of goods by specification or order where the price is paid progressively in accordance with the progress of a job. An example would be for the purchase of a house to be constructed, payments are made to the developer or builder according to the stage of work completed. This type of financing along with *bai salam* are used as purchasing mechanisms, and *murabaha* and *bai muajjal* are for financing sales.

- Ju'alal: Lit: stipulated price for performing any service. Technically applied in the model of Islamic banking by some. Bank charges and commission have been interpreted to be *ju'ala* by the jurists and thus considered lawful.

- Nisab: Exemption limit for the payment of *zakah*. It is different for different types of wealth.

GLOSSARY OF ISLAMIC FINANCIAL TERMS (CONT.)

- Qard al hasan

  A virtuous loan. A loan with the stipulation to return the principal sum in the future without any increase. Usually given for either welfare purposes or for fulfilling short-term funding requirements.

- Qard:

  Qard is a loan, free of profit. This arrangement is used for Bank Current Accounts. In essence, it means that your Current Account is a loan to the bank, which is used by the bank for investment and other purposes. Obviously it has to be paid back to you, in full, on demand.

GLOSSARY OF ISLAMIC FINANCIAL TERMS (CONT.)

- Riba
  This term literally means an increase or addition. Technically it denotes any increase or advantage obtained by the lender as a condition of the loan. Any risk-free or "guaranteed" rate of return on a loan or investment is *riba*. *Riba*, in all forms, is prohibited in Islam.

- Rabbul-mal: owner of capital.

- Sadaqah: Charitable giving.

GLOSSARY OF ISLAMIC FINANCIAL TERMS (CONT.)

- Shari'a: Islamic cannon law derived from 3 sources: the Quran; the Hadith (sayings of the Prophet Muhammad); and the Sunnah (practice and traditions of the Prophet Muhammad).

- Shirkah: A contract between two or more persons who launch a business or financial enterprise to make profit, also known as Musharika

- Tawarruq or Reverse Murabahah. As used in personal financing, a customer with a genuine need buys something on credit from the bank on a deferred payment basis and then immediately resells it for cash to a third party. In this way, the customer can obtain cash without taking an interest-based loan.

GLOSSARY OF ISLAMIC FINANCIAL TERMS (CONT.)

- Takaful: Mutual support which is the basis of the concept of insurance or solidarity among Muslims.

  This is a form of Islamic insurance based on the Quranic principle of *Ta'awon* or mutual assistance. It provides mutual protection of assets and property and offers joint risk sharing in the event of a loss by one of its members. *Takaful* is similar to mutual insurance in that members are the insurers as well as the insured. Conventional insurance is prohibited in Islam because its dealings contain several *haram* elements including *gharar* and *riba*, as mentioned above.

GLOSSARY OF ISLAMIC FINANCIAL TERMS (CONT.)

- Wadiah (Safekeeping)

  In Wadiah, a bank is deemed as a keeper and trustee of funds. A person deposits funds in the bank and the bank guarantees refund of the entire amount of the deposit, or any part of the outstanding amount, when the depositor demands it. The depositor, at the bank's discretion, may be rewarded with a 'hibah' (gift) as a form of appreciation for the use of funds by the bank.

- Zakah/Zakat: A tax which is prescribed by Islam on all persons having wealth above an exemption limit at a rate fixed by the *Shariah.* According to the Islamic belief *Zakah* purifies wealth and souls. The objective is to take away a part of the wealth of the well-to-do and to distribute it among the poor and the needy. It is levied on cash, cattle, agricultural produce, minerals, capital invested in industry, and business etc. The distribution of *Zakah* fund has been laid down in the Qur'an (9:60) *Zakah* is the third pillar of Islam. It is an obligatory contribution which every well-off Muslim is required to pay to the Islamic state, in the absence of which individuals are required to distribute the *Zakah* among the poor and the needy as prescribed by the *Shari´a.*

For a more detailed presentation or additional material pertaining to Islamic Banking and Finance, please contact Fadi Matar on 04 3178123 / fadimatar@dubaibank.ae

Q&A – Dubai Bank

Q&A

- **What is Islamic banking?**
- Islamic banking refers to a specific type of ethical investing or banking. It prohibits the use of money as a commodity and therefore outlaws usury or riba. All transactions need to be asset backed.
- The five essential principles on which Islamic banking is based consist of:
  - Prohibition on Interest (riba)
  - Prohibition of Uncertainty (gharar)
  - Prohibition on Speculation or gambling (maisir)
  - Restriction on activities/commodities e.g. Alcohol, Arms and Ammunition and Pork are prohibited activities
  - Profit and loss sharing mechanism to equitably share the risks and rewards of a transaction
- **What is the difference between conventional and Islamic banking?**
- As explained above – the prohibition on usury and the requirement for transactions to be asset backed are key differences between Islamic and conventional banking. [In Islamic Banking you take a profit, whereas the conventional system refers to it as interest].

Q&A

- **Why are we going Islamic?**
- Islamic Banking is going through a significant growth phase in the region and the products & services on offer require major improvement. From a longer term strategic perspective, we will grow in the Islamic finance arena at a much faster pace than our competition as we feel we are well positioned to deliver superior and innovative products & services. In addition, conversion will allow us to focus and nurture the Bank's geographical expansion regionally and internationally.
- In view of the above, the Bank's Board of Directors and Owners have decided to enter the Islamic Finance arena in order to deliver innovative solutions that will permit Dubai Bank to grow into one of the largest Banks, not only in the country but also in the region.
- **Why does the bank want to restrict its areas of activity?**
- The Bank is not intending to restrict its areas of activity. On the contrary, with a new focus on Islamic banking, Dubai Bank intends to bring about an expansion of the services, products and activities that it currently is involved in. The only difference will be that these services, products and activities will be Shari'a compliant.

Q&A

- **Why doesn't the bank want to do what most other conventional banks are doing, i.e. have an Islamic window?**
- We believe that doing business on both the conventional and Islamic sides of the banking sectors will not be focused enough and thus not allow a true impact on the Islamic banking sector. To function in both business areas, Dubai Bank will likely remain a small conventional bank with some Shari'a compliant products. This will in no way properly distinguish it from any other local bank. However, if we set out in a focused manner to make Dubai Bank a dynamic Islamic alternative, with the objective of continuing to deliver superior products and services to market, we will make a far stronger impact on our selected business area.
- **When will the conversion take place?**
- We are targeting the first quarter of 2007.
- **How long will the process of conversion take?**
- The conversion process will take a year or so. A lot of preparatory work has already been done.
- **Which businesses will stay and which will go?**
- Dubai Bank aims to offer a complete array of financial services. This means that we will continue to offer retail and merchant banking services.

Q&A

- What will happen to existing businesses?
  - Corporate
- Corporate Banking is one of the largest business segments for Islamic Banks especially in contract financing, project finance, Asset Finance and trade finance areas. Majority of the products offered currently by Corporate Banking can be offered in Islamic Banking. The product team for Islamic Banking will be reviewing the Islamic versions of the products to ensure that a complete suite of products are available for the Bank's existing customer base as well. For instance, the product team has already identified a solution for the Bank's FI portfolio, allowing the Bank to continue investment in this medium return low risk business.
  - Retail
- The retail products, including Auto Loans and Personal Loans, have Islamic counterparts / versions. Credit Cards are offered by ADIB, Emirates Islamic Bank, Al Rajhi Bank, where the Banks charge processing fees for giving revolving facilities. The product team will review the existing Islamic versions of the credit cards available regionally / internationally and will endeavour to develop a product superior to existing Islamic Credit Cards currently available. In addition, the Bank will get into Mortgage Finance business, the market for which has grown significantly in the last couple of years.

Q&A

- Treasury

- Currently, the Islamic Banks are not allowed to trade in derivatives / hedge funds or interest bearing papers. However, Islamic Finance as an industry is in its infancy and in our opinion, alternatives to these products will eventually be available. Developing such effective counterparts to existing products will give the Bank a competitive edge. In addition, there is a significant gap in the liquidity management solutions available to Islamic Banks. The Bank's Treasury will work towards identifying solutions to such gaps and certain ideas are already being considered.

- Investment Sales

- The Bank will not be able to sell structured notes paying interest. However, similar structured products compliant with Shari'a principles are being developed by large banks in Europe and in a few years it is likely that effective counterparts will be available. However, the bank also wishes to establish a large Asset Management business investing funds in products / businesses, which are Shari'a compliant. Investment Sales in the Islamic Bank will be involved in distribution of third party Islamic funds, in house managed / originated funds and the IPO's etc.

Q&A

- **If Credit Cards do not exist, will there be a significant decrease in support staff considering that Credit Cards earns the most and requires highest support?**
- Islamic banks are increasingly beginning to offer Shari'a compliant versions of credit cards that are not simple debit cards. Therefore, Dubai Bank will also strive to develop its own solutions. In addition, there will be other products that will be launched that currently do not exist in our conventional operations like mortgages that will require an equally extensive support infrastructure.
- **What will happen to the Credit Cards business when we go Islamic?**
- Credit Cards are offered by a number of Islamic Banks and present a strong proposition. Some of the benefits on our current product will have to change and the fees will have to be amended. We are currently working on developing the product manuals under the Islamic structure in order to develop the complete retail strategy from a product offering point of view. We hope to have a clearer plan by the second quarter this year, which will be shared with you. In the meantime, it's business as usual.

Q&A

- What are the products in an Islamic Bank and will these products require complex MIS as in Conventional Banking?
- The product offering in the Islamic Bank will be more than that of a Conventional Bank. However, certain products adversely affected in the short term will be Investment Sales and Treasury Sales. MIS requirements will be more complex in Islamic Banking.
- Will there be a significant impact on Bank's costs due to conversion, impacting increments / incentive to staff?
- Employees' salaries, allowances and bonuses will not be negatively affected as a result of the conversion. A budget has been allocated for the conversion and this is completely separate from the payroll and system of performance bonuses administered by HR.

Q&A

- **What is the bank's strategy going forward?**
- The bank's overall strategy going forward will be as follows:
- Offer all products in Commercial and Investment Banking businesses; with focused target products for each customer segment.
- Identify existing gaps in the Islamic Finance industry and develop product solutions to address the industry's requirements ensuring quick successes for the Bank.
- Offer superior and innovative products to those delivered by other Islamic Banks with the value proposition to be at least similar to Conventional Banks, if not more.
- Geographically export the Islamic Banking model regionally and internationally in 5 to 10 years.
- Target markets to include developing economies (GCC, Levant, North Africa, Central Asia, CIS, South East Asia and the Indian Subcontinent) rather than developed economies.
- Build up Capital Markets / Funds Management / Corporate Finance businesses to take advantage of the economic boom and developing capital markets in the region.
- Offer excellent growth prospects to key performing employees of the Bank and to be perceived as a Modern Islamic Financial Institution in line with Dubai's brand image.
- The above strategy does not include the opportunities that may arise due to the Bank being majority owned by Dubai Holding.

Q&A

- **Will my career be affected in anyway?**
- Yes, positively. It is a fact that Islamic banking is a boom area. It is also a fact that many of the best people in this field are a) non-Muslims and b) committed to Islamic banking for business, not ideological reasons. Finally, it is a fact that candidates with experience in Islamic banking can command higher salaries than those from a conventional banking background as a result of supply and demand. Some employees may not wish to stay in Islamic banking because they feel that this would be detrimental to their careers but these will be personal decisions.
- **I am not a Muslim? Will I lose my job?**
- No. Islamic institutions are run by people of all religions.
- **Would the branch concept change from selling point to service point?**
- Our delivery channels will remain pretty much the same. We will however look to enhance our on-line capabilities. Branches will continue to be the key channels and we will be adding more locations as we progress with our expansion plans.
- **Will the number of staff decrease?**
- No. It will continue to increase as we add new businesses and expand our current operations.

Q&A

- **Will there be a separate branch / section for ladies?**
- This is something that will be considered however, it remains to be an option.
- **What will be the working hours?**
- The working hours will remain the same. Islamic Banking does not affect work timings.
- **Will the organisational chart change?**
- Yes. The organizational chart will change to cater for the new business lines as well as new products and services.
- **Will the work environment be considerably more conservative?**
- The bank will continue to promote a great working environment. No, the environment will not become more conservative, it will remain as it is, however, the front end staff may have to adhere to some minor dress codes.
- **What will happen to my existing auto loan?**
- The loan will continue. The only change will be at the back end, i.e. on our accounting procedures.

Q&A

- **What will happen to my existing personal loan?**
- Same as above. To add to both points, once the loan period is over, all new loans will be issued under the Islamic principles.
- **My credit card has an outstanding amount that I roll over monthly. What will happen to this?**
- We are still studying a number of viable options to manage this process.
- **Can non-Muslims work in customer facing roles and in back office roles?**
- There is no prohibition on non-Muslims performing any role, front or back office, in an Islamic institution. There are many non-Muslims in prominent positions in Islamic institutions – e.g., CEOs of Arab Banking Corporation's Islamic Asset Management, and the European Islamic Investment Bank; Chief Operating Officer of Tamweel; Head of Corporate Banking in Sharjah Islamic Bank. Also, non-Islamic institutions such as Deutsche, HSBC and Citibank are often at the cutting edge of new product innovations that are developed by non-Muslims whilst many prominent legal firms have non-Muslims heading their Islamic banking practices.
- In addition, Dubai Bank wants to appeal to mainstream customers and does not wish to project a highly conservative image, rather a moderate yet Shari'ah compliant one. This is especially important as the Bank has regional ambitions in exporting its business model. In a cosmopolitan environment like Dubai, the moderate Malaysian approach to Islamic banking is more applicable where the majority of clients are non- Muslim and would be served by multicultural employees that are reflective of the society.

Q&A

- **Do non-Muslims have a career in the bank over the medium term?**
- Yes. See previous question.
- **What will be the longer term career impact of working for an Islamic Bank, if the staff wishes to move back home or immigrate to another country in the medium term?**
- It depends. Quite apart from the issue of Islamic banking, many employers in the West do not value experience gained in the Middle East as valid as that gained in the West. Rightly or wrongly, this is a fact. What is true, and something that any recruitment consultant would confirm, is that getting a job in the West depends on having marketable skills and qualifications and also on how these are presented by a candidate to a prospective employer. Because there is very little difference between the core functions of Islamic and conventional banks, in real terms, there would be no impact on the career profile of the average employee.
- **Will working for an Islamic Bank impact a candidate's prospects with a conventional bank in the region in the medium term?**
- Not at all. Conventional bankers understand the complexities of Islamic banking and know that the experience gained is invaluable.

Q&A

- **What will the dress code be? Will make-up be permitted?**
- At this stage, we do not know but our working assumption is that there will be very little change except in some branches (e.g. Sharjah) where ladies might be required to cover their hair.
- **I know nothing about Islamic banking? How will I learn?**
- HR is currently organizing training courses for all staff. The bank will ensure that you are fully trained and capable to manage all aspects of your job with respect to the conversion.
- **When will training commence?**
- Training has already commenced for some groups and it will continue for the next 6 months or so.

Q&A

- **Would Muslim staff be better at selling than non-Muslims as Muslim's might have the product knowledge?**
- Not necessarily. It is not about your religion, it is about how much you know. All products will be attested by the Shari'a which means that the customer will already have extended his trust in the Islamic element; it is up to ones sales skill to close the sale.
- **There are other questions that I need answers to. Is there a help desk I can call at anytime for clarification?**
- Yes. You may call Fadi Matar on 04 3178 123 or e-mail him for any clarification. Your questions will be treated with the strictest confidence and privacy.
- Additionally, you may refer to the Intranet [Share-point] - Islamic Banking file.